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In the Matter of

MICHAEL T. MOREFIELD
Complainant
v.
EXELON SERVICES, INC., and
EXELON CORPORATION
Respondent
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Case No. 2004-SOX-00002

ORDER DENYING MOTION TO DISMISS COMPLAINT FILED BY EMPLOYEE OF NON-PUBLICLY TRADED CORPORATE SUBSIDIARY

By motion filed January 21, 2004, Respondents Excelon Services and Excelon Corporation seek dismissal of a whistleblower complaint under the employee protection provisions of Public Law 107-204, Section 806 of the Corporate and Criminal Fraud Accountability Act of 2002, Title VIII of the Sarbanes-Oxley Act of 2002. 18 USC §1514A. (hereinafter, Sarbanes-Oxley). Sarbanes-Oxley covers employees of publicly traded companies, there contractors, and agents from retaliatory or discriminatory actions by the employer.

On May 21, 2003, Michael Morefield, formerly Vice President-Finance for Excelon Services, filed a complaint with OSHA alleging that he was subjected to discriminatory threats, intimidation, and eventually terminated for reporting internal accounting control deficiencies and efforts by top management intentionally to manipulate the monthly financial results, forecasts and accounting records to make Excelon Services' performance appear better than the actual results. Attached to Morefield's OSHA complaint was a copy of a complaint he filed in state court alleging, *inter alia*, more detailed facts recounting his protected activities relating to alleged improper accounting treatment of vacant leases, intentional and improper balance sheet adjustments, improper manipulation of

financial forecasts during the latter part of 2002, improper manipulation of the 2003 budget, and improper accounting treatment of liabilities for Bumler Mechanical, a business unit of Excelon Services.[1] On September 16, 2003, OSHA dismissed Morefield's complaint, and Morefield subsequently requested a hearing.

Respondents now move to dismiss the complaint for two independent reasons. First, Respondents contend that the whistleblower provisions of Sarbanes-Oxley are not available to Morefield because he was not an employee of a publicly traded company, but rather worked for a subsidiary of a subsidiary of a publicly traded company, Excelon Corporation.[2] Second, Respondents argue that even if Morefield was a protected employee, his activities did not constitute whistleblowing within the meaning of Sarbanes-Oxley because the financial information that was allegedly "manipulated" consisted of internal and interim financials of a subsidiary, was not shared with investors, lenders, or other third parties, and had no material effect on quarterly or annual statements or other

[1] Citing Ford v. Northwest Airlines, Inc., 2002 AIR 21, at n.3 (ALJ Oct.18, 2002), and 18 U.S.C. 1514A(b)(2)(D), Respondents contend that any "new claims" that Morefield failed to raise within 90 days of his termination and allegations which were not raised and investigated by OSHA are not properly subject to adjudication in this proceeding. Respondents' reading of these authorities is partially correct. Both the case law and the statute make clear that a complainant has 90 days from the "date of the violation" to file his or her complaint. The violation, however, is not the whistleblower's protected conduct, it is the retaliatory action which it allegedly triggered. In this instance it was the termination, and, although there are exceptions not here pertinent, Morefield generally would not now be free to charge additional violations. In contrast, neither Ford nor the statute require that every instance of protected activity be brought to OSHA's attention or that OSHA investigate every instance that is alleged in a complaint. The scope of an OSHA investigation does not establish boundaries of the factual inquiry permitted in the subsequent adjudication. After 90 days, new violations generally may not be raised, but the statute and the implementing regulations contemplate both discovery and a *de novo* hearing of the facts relating to both the protected activities and the reasons for the adverse action regardless of OSHA's findings. It involves no transgression of the "two tiered" scheme for handling whistleblower claims to adjudicate fully the circumstances of a timely filed complaint.

[2] Historically, as Congress expanded whistleblower coverage to workers in various industries, efforts to limit the class of protected employees inevitably surfaced. For example, when the nuclear industry was covered by the Energy Reorganization Act, 42 U.S.C. 5851, the issue arose as to whether job shoppers employed by a third party but working at a nuclear power plant construction site, were employees of the power plant construction contractor within the meaning of the Act . In O'Brien v. Stone & Webster Engineering Corp. 1984-ERA-31 (ALJ, Feb 28, 1985), the job shoppers were covered. A contrary result, the O'Brien decision noted "would provide an incentive to replace covered workers with unprotected job shoppers thereby reducing the risk of unwelcome "whistleblowing." Consequently, although Section 5851 does not define the term "employee", a broad interpretation, which includes job shoppers within the protected category of covered workers, seems compatible with the legislative history of the Act, the overall statutory framework, and the actual manner in which job shoppers are used at Nine Mile II." *See, also*, Hasan v. System Energy Resources, Inc. 1989-ERA-36, (ALJ Aug. 2, 1989), aff'd (Sec'y Sept. 23, 1992) aff'd, (5th Cir. No. 94-40281). (Seconded engineers covered). *Compare*, Caimono v. Brinks, Inc., 95-STA-4, in which the Secretary reversed an ALJ decision which had held a messenger was not a covered employee within the meaning of the Surface Transportation Act. *See*, ((Sec'y Jan. 26, 1996), reversing (ALJ D&O, Sept. 7, 1995),

information publicly disclosed by Excelon Corporation. The amounts involved, Respondents emphasize, totaled less than .0001% of the $15 billion in Excelon Corporation's annual revenues. For the reasons set forth below, Respondents' Motion to Dismiss is denied.

Whistleblower Coverage of Employees of Non-Publicly Traded Subsidiaries of Publicly Traded Corporations

Respondents argue that Morefield is not protected by the whistleblower coverage of Sarbanes-Oxley because he is merely the employee of a relatively small subsidiary of a huge publicly traded company, and the subsidiary is not publicly traded. Respondents believe the legislative history of the act confirms the limitation they would impose, and construe Section 806 of Sarbanes-Oxley as "narrowly" defining the types of companies and employees subject to the whistleblower provisions. Indeed, Respondents cite two recent cases which they embrace as lending support for the narrow interpretation they urge me to apply. Before reviewing the case law, we turn to the statute.

Sarbanes-Oxley Purpose and Intent
I.

It would seem neither necessary nor especially helpful to engage in a lengthy recitation of the legislative history which persuaded Congress of the need for the type of reforms embodied in Sarbanes-Oxley. It should suffice simply to recall that shortly before, and contemporaneous with, its enactment, accounting scandals in some circles were causing painful economic dislocations among investors, lenders, and employees of several major firms and undermining investor confidence in the integrity of financial markets. Finding the status quo unacceptable, Congress set about to refashion the regulatory and private sector environments which had failed to detect or affirmatively allowed deception in the reporting of corporate value and performance and permitted the type of shenanigans which brought several large concerns down in ruins and rocked others to their very foundations. To prevent the recurrence of such chicanery in the future, Congress examined the ethical standards and accounting and reporting systems flaws and failures which, in some instances, allowed fraud to flourish. Intent upon reforming the regulatory and private sector environments which allowed the fleecing to take place, Congress was determined to reassure the markets that effective preventive and exposure measures could be formulated, and it turned, among other remedies, to a valuable deterrent resource it had used in the

past to help insure compliance with its mandates: the employees within an organization who were willing to blow the whistle.

Congress has long employed the inside whistleblower as a first line of defense against various types of abuses which it deems unacceptable. Moreover, it understands the risks it beckons the whistleblower to accept, and it endeavors to protect them.[3] Under such circumstances, it does not serve the purposes or policies of the act to take too pinched a view of this remedial statute when it comes to protecting those in an organization who can address the concerns Congress sought to correct.

II.

Considered in context, it seems clear that Congress intended the term "employees of publicly traded companies" in Section 806 to include the employees of the subsidiaries of publicly traded companies. Complainant argues that the statute covers employees of agents and contractors of the publicly traded company without regard to whether these entities are publicly traded, and the subsidiaries of a publicly traded company should similarly be considered "agents" for accounting and financial reporting purposes.

While it would not seem inappropriate to view subsidiaries as "agents" of the publicly traded company as Complainant suggests, the subsidiaries, for Sarbanes-Oxley purposes, are more than mere agents like an outside auditor or consultant. Subsidiaries like Excelon Services are an integral part of the publicly traded

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[3] As recently observed in observed in Daniel v. Timco Aviation Services, Inc., 2002-AIR-00026, June 11, 2003:

> It does not stray beyond the proper realm of administrative adjudication to postulate, *a priori,* that if reprisals, especially of a permanent nature or constituting a pattern of harassment, are allowed against an activity valued in the public interest, society is likely to get less of the valued activity. Conversely, one protects the behavior one wishes to promote; and this seems to be what Congress intended in dealing with the type of activity covered by the whistleblower statutes. Thus, in fostering the substantial public interest reflected in such enactments as the Air 21(Airline Industry); Energy Reorganization Act of 1974, as amended, Section 211, 42 U.S.C. §5851(Nuclear Industry), Clean Air Act, 42 U.S.C. §7622; the Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. 9610; the Solid Waste Disposal Act, 42 U.S.C. §6971; the Safe Drinking Water Act, 42 U.S.C. 300j-9; the Federal Water Pollution Control Act, 33 U.S.C. §1367; Surface Transportation Assistance Act, 49 U.S.C. §31105 (Trucking Industry); the Toxic Substances Control Act, 15 U.S.C. §2622, and Sarbanes-Oxley Act of 2002, 18 U.S.C §1514A , the legislature sought to encourage workers voluntarily to communicate their environmental, safety, and certain other concerns while condemning discriminatory actions which target the activities Congress deemed beneficial in the public interest. Whistleblowing is protected; retaliation is discouraged, not the reverse.

company, inseparable from it for purposes of evaluating the integrity of its financial information, and they must be treated as such. Thus, Congress insisted, for example, that subsidiaries be subject to internal accounting controls and that material information relating to the consolidated subsidiaries be conveyed to officials certifying annual or quarterly reports. Section 302(a)(4)(B) specifically provides that the corporate officers who sign the annual and quarterly reports "have designed such internal controls to ensure that the material information relating to the issuer and its consolidated subsidiaries is made known to such officers by others within those entities, particularly during the period in which the periodic reports are being prepared…." [4] Obviously, such requirements make it more difficult for top management of a publicly traded company to shed responsibility for the financials of a subsidiary by virtue of mere ignorance. Measures like these adopted by Sarbanes-Oxley to ensure the integrity of the organization's accounting practices pay no heed to the technicalities of internal corporate veils.

In addition, Sarbanes-Oxley enhanced the role of the audit committee. Section 2(a)(3)(A) of the Act defines the term "audit committee" as a committee established by the corporate board of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer…." Indeed, in this instance, it appears that Excelon Corporation's audit committee may have inquired into Morefield's concerns. Further, Section 301 of the Act provides that the Audit Committee of each issuer must establish procedures for "(A) The receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal controls (encompassing, *inter alia*, subsidiaries as noted above), or auditing matters; and (B) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters." Internal whistleblowing at all levels is obviously encouraged; however, many whistleblowers, like Morefield, are not in a position to maintain anonymity. The choices Morefield allegedly confronted could not remain cloaked in anonymity, and employees in that position need statutory protection.

Thus, the structure, language and purpose of Sarbanes-Oxley afford a bit more protection than Excelon would allow, encompassing the employees of its subsidiaries. The publicly traded entity is not a free-floating apex. When its value and performance is based, in part, on the value and performance of component entities within its organization, the statute ensures that those entities are subject to

[4] What may constitute "material information" and whether covered protected activity should it be limited to concerns about such information or construed to include concerns about process and incipient inaccuracies which may impact, directly or indirectly "material information" is a separate question addressed *infra.*

internal controls applicable throughout the corporate structure, that they are subject to the oversight responsibility of the audit committee, and that the officers who sign the financials are aware of material information relating to the subsidiaries. A publicly traded corporation is, for Sarbanes-Oxley purposes, the sum of its constituent units; and Congress insisted upon accuracy and integrity in financial reporting at all levels of the corporate structure, including the non-publicly traded subsidiaries. In this context, the law recognizes as an obstacle no internal corporate barriers to the remedies Congress deemed necessary. It imposed reforms upon the publicly traded company, and through it, to its entire corporate organization.

Under these circumstances, the scope of Sarbanes-Oxley whistleblower protection tracks the flow of financial and accounting information throughout the corporate structure and remains as permeable to the internal "corporate veils" as the financial information itself. I conclude that employees of non-public subsidiaries of publicly traded companies are covered by the whistleblower protection provisions of Sarbanes-Oxley.

Recent Cases
I.

As noted above, Respondents invoke the holdings of two recent cases which they construe as analogous to the question at issue here. In Flake v. New World Pasta Co., 2003 SOX 18 (ALJ, July 7, 2003), a Sarbanes-Oxley complaint was dismissed because the employer did not issue a class of securities covered by the Act. In Powers v. Pinnacle Airlines, Inc., 2003 AIR 12 (ALJ, March 5, 2003), the Sarbanes-Oxley count in a complaint was dismissed, as Respondents read that decision, on the ground that the employer was not a publicly traded company, but rather, as here, the subsidiary of a publicly traded company, Northwest Airlines. In Respondents' view, the Pinnacle Airlines case "is controlling here and requires dismissal of Morefield's Sarbanes-Oxley complaint." I have carefully considered Respondents' contentions. The decisions rendered by my colleagues are distinguishable.

Thus, in Flake, the company issued publicly traded indentures, but it was not an issuer with a class of securities registered under Section 12 of the Securities Exchange Act of 1934 ("SEA of 1934") and it was not required to file reports under Section 15(d) of the SEA of 1934. See, 18 U.S.C. Section 1514(A)(a). As such, Flake concluded that the whistleblower provisions of Sarbanes-Oxley were unavailable because no publicly traded company was involved in the matter. Carefully considered, Flake provides no guidance here. Sarbanes-Oxley's

coverage for an employee of a subsidiary of a publicly traded company was not an issue Flake addressed.

Pinnacle Airlines is similarly distinguishable. As Respondents correctly note, Pinnacle Airlines was a subsidiary of a subsidiary of Northwest Airlines, Inc., and the decision in Pinnacle Airlines mentioned that the employer was not a publicly traded company. The Sarbanes-Oxley count in the complaint was dismissed, however, because the Complainant had failed to name the publicly traded entity, Northwest Airlines, Inc., as a party respondent. Accordingly, the Judge ruled that the named party, Pinnacle Airlines, was not publicly traded and Northwest Airlines, Inc., was "not properly before" her. Unlike the Complainant in Pinnacle Airlines, however, Morefield did name the publicly traded entity, Excelon Corporation, in the complaint he filed with OSHA. Thus, the publicly traded company is properly before me in this proceeding.

II.

Beyond that, however, to the extent that dicta in Pinnacle Airlines suggests, as Respondents here contend, that the employees of a subsidiary of a publicly traded company must "pierce a corporate veil" within their own chain of command before they are entitled to the whistleblower protections of Sarbanes-Oxley, I must, for the reasons discussed in detail above, respectfully disagree. Nothing in the Act persuades me that Congress intended to wall off from the whistleblower protection Sarbanes-Oxley vast segments of corporate America that reside under the umbrella of publicly traded companies.

Exelon Services, for example, is a subsidiary of Exelon Enterprises, which is a subsidiary of Exelon Corporation. Yet, Exelon Services is but one of several subsidiaries of Exelon Enterprises, and Exelon Enterprises is but one of several subsidiaries of Exelon Corporation. If Exelon's interpretation of Pinnacle Airlines were accepted, not a single whistleblower in Exelon Corporation's vast network of non-publicly traded corporate subsidiaries would be entitled to Sarbanes-Oxley whistleblower coverage, and a precedent like that would apply equally to many, if not most, of the large publicly traded companies. Such a result would not further the objectives of the Act, but would serve only to stifle or discourage the free flow of potentially crucial information emanating out of countless subsidiaries throughout the economy. To limit whistleblower coverage exclusively to those in the know, and their contractors or agents, at the level of the corporate parent is not compatible with the Act's intended purpose.

For all of the foregoing reasons, I conclude that the term "employee of publicly traded company," within the meaning of Sarbanes-Oxley, includes all employees of every constituent part of the publicly traded company, including, but not limited to, subsidiaries and subsidiaries of subsidiaries which are subject to its internal controls, the oversight of its audit committee, or contribute information, directly or indirectly, to its financial reports. In summary, the term "employee of a publicly traded company" as used in the caption of the whistleblower provision of Sarbanes-Oxley is sufficiently broad to include the Vice President-Finance of a non-publicly traded subsidiary, within and integral to, the corporate structure of Exelon Corporation.

Blowing the Whistle on Allegedly Improper Manipulation of Internal Reports

Respondents also contend that Morefield's complaint must be dismissed for several other reasons. First, his whistleblowing concerned alleged manipulations of financial information in *internal* reports, budgets, and forecasts, and it is no violation of any rule or law, Exelon argues, for the management of a subsidiary to deceive the parent as long as the *external* financial reports and statements are not effected. Since no third party was misled or defrauded, Exelon continues, no federal interest was implicated, and consequently, no Sarbanes-Oxley coverage is available for the concerns Morefield expressed. Beyond that, Respondents emphasizes that Morefield's questions involved only about $2 million or less than .0001% of Excelon Corporation revenues, and therefore, he had no reasonable basis for believing his concerns were material. Finally, Respondents note that Morefield did not identify the rule, law, or regulation that the alleged manipulation would have violated. I have considered each argument. None warrants dismissal at this stage of the proceeding.

I find no basis in the Act for concluding that the manipulation a whistleblower identifies as inappropriate must actually appear in an external report or statement before the Act's protections are triggered. The value of the whistleblower resides in his or her insider status. These employees often find themselves uniquely positioned to head off the type of "manipulations" that have a tendency or capacity to deceive or defraud the public. By blowing the whistle, they may anticipate the deception buried in a draft report or internal document, which if not corrected, could eventually taint the public disclosure. Beyond that, their reasonable concerns may, for example, address the inadequacy of internal controls promulgated in compliance with Sarbanes-Oxley mandates or SEC rules that impact on procedures through out the organization, or the application of

accounting principles, or the exposure of incipient problems which, if left unattended, could mature into violations of rules or regulations of the type an audit committee would hope to forestall.

Thus, whistleblower protection extends not only to criminal violations involving securities, bank, and postal fraud situations, but violations of any SEC rule or any federal law broadly "relating to fraud against stockholders." Section 1514A(a)(1). The latter provision may provide ample latitude to include rules governing the application of accounting principles and the adequacy of internal accounting controls implemented by the publicly traded company in compliance with such rules and regulations.

Nor would it, as Complainant correctly contends, be appropriate in the abstract to dismiss, as a matter of law, complaints based upon concerns emanating out of a subsidiary that appear relatively insignificant in dollar value when compared with the revenues of the corporate parent. The dollar value of the "manipulation" in a subsidiary may simply distort the importance of the accounting principles at issue if applied throughout the organization, and Complainant correctly notes that Sarbanes-Oxley places no minimum dollar value on the protected activity it covers. Whether or not "materiality" is a required element of a criminal fraud conviction as Respondents contend, we need be mindful that Sarbanes-Oxley is largely a prophylactic, not a punitive measure. The mere existence of alleged manipulation, if contrary to a regulatory standard, might not be criminal in nature, but it very well might reveal flaws in the internal controls that could implicate whistleblower coverage for seemingly paltry sums. Accordingly, for all of the foregoing reasons;

ORDER

IT IS ORDERED that Respondents' Motion to Dismiss be, and it hereby is, denied.

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Stuart A. Levin
Administrative Law Judge